European Commission publishes an EU corporate tax system for multinational companies

Tax Update

26 OCT 2016
By: Jian-Cheng Ku | Jesse Peeters

On October 25, 2016, the European Commission published four proposals for corporate tax directives that potentially will apply in 27 Member States (28 - UK) of the European Union: the Common Corporate Tax Base (CCTB) directive, the Common Consolidated Corporate Tax Base (CCCTB) directive, a proposed amendment to the Anti-Tax Avoidance Directive that is already in effect (ATA Amendment Directive) and a directive on Double Taxation Dispute Resolution Mechanisms in the European Union (Dispute Resolution directive). If adopted, the CCTB and the CCCTB will be mandatory for all multinational groups that operate in the EU and have a consolidated revenue exceeding €750 million. The aim of these directives is to combat tax avoidance by multinational companies in the EU and at the same time reduce compliance costs, and improve legal certainty for multinational groups. In addition, the ATA Amendment Directive contains anti-abuse rules with regard to hybrid mismatch arrangements involving third countries. Finally, the double taxation dispute resolution mechanism directive aims to improve the current dispute resolution mechanisms that are in place in the EU. It should be noted that these directives are still proposals and need unanimous approval of all Member States to be adopted. Therefore, immediate action is not needed at this time.

Executive summary

If adopted by the EU Member States, the three proposed corporate tax directives that were published by the European Commission will have a significant impact on the corporate tax position of multinational groups that operate in the European Union. The CCTB directive and CCCTB directive are mandatory for all multinational groups with a consolidated revenue of 750 million. The CCTB proposal contains common rules to calculate and determine the tax base in each EU Member State, thus limiting planning opportunities for multinational groups. As a benefit to taxpayers, the CCTB directive also contains a significant deduction for R&D expenses and a temporary mechanism for cross-border loss relief. The CCTB and CCCTB directives have been and will likely continue to be subject to fierce debate among EU Member States. Under the CCCTB directive, the profit of multinational groups in the EU are consolidated for corporate tax purposes. Consequently, profits of multinational groups are allocated to the EU Member States in which the group is active by means of a formulary apportionment, replacing the current transfer pricing rules.

If approved, the CCTB would enter into force on January 1, 2019 and the CCCTB directive would enter into force as per January 1, 2021.

The third directive is the ATA Amendment Directive. The original ATA Directive was adopted on 23 June, 2016. Under the ATA Amendment Directive, the anti-abuse rules with respect to hybrid mismatch arrangements will also apply in relation to third countries, whereas the original ATA Directive only contains anti-abuse rules against hybrid mismatch arrangements within the EU. The ATA Amendment Directive should be implemented by the EU Member States in their local laws by 31
December, 2018.

The fourth directive is the double taxation dispute resolution mechanism directive. This directive aims at improving the current dispute resolution mechanism that is in place in the EU (EU Arbitration Convention on the elimination of double taxation), which has many shortcomings with regard to scope, timeliness and conclusiveness. This directive should be implemented by the EU Member States in their local laws by 31 December, 2017.

Brief history of the ATA Amendment, CCTB and CCCTB directives

The initial CCCTB proposal, which included tax consolidation and common rules with respect to the calculation and determination of the tax base was presented by the European Commission in 2011. This proposal which was incredibly ambitious at the time, was dismissed by the EU Member States primarily out of fear of losing corporate tax income and tax sovereignty. However, in light of recent tax developments such as the OECD BEPS Action Plan and the State Aid cases, the CCCTB proposal was put forward again by the European Commission.

In 2015, the European Commission decided to apply a two-stage approach towards an EU-wide corporate tax system. The first stage is the CCTB proposal containing common rules with regard to the calculation and determination of the tax base in each EU Member State. The second stage is to create full tax consolidation of the revenues of multinational groups within the EU. The EU Member States will first have to agree on the CCTB directive and subsequently start negotiations on the CCCTB proposal. It should be pointed out that the Brexit vote of June this year has improved the likelihood of the CCTB and the CCCTB proposal to be adopted. The UK was regarded as the most important opponent of the initial CCCTB proposal.

The original ATAD Directive was adopted by the European Commission on June 23, 2016. The ATAD Directive contains certain anti-abuse rules against tax evasion of multinational group and includes a statement that requests the Commission to put forward a proposal by October 2016 on hybrid mismatches involving third countries.

CCTB proposal

The CCTB proposal will have a significant impact on the corporate tax system that is applicable to multinational companies in the EU. Going forward, there may be a common set of rules to calculate and determine the taxable profits in all EU Member States. If implemented, the tax base of multinational companies will consist of all revenues unless expressly exempted. Under a participation exemption regime, income consisting of dividends or proceeds from the disposal of shares held in a company outside the group will be exempt for participations of at least 10 percent that have been held for at least 12 months, in order to prevent the double taxation of foreign direct investment.

Other aspects of the CCTB proposal inter alia include:

- **Super-deduction for R&D costs:** to support innovation in the economy, the CCTB proposal introduces a so-called super-deduction for R&D costs. The baseline rule is that R&D costs will be fully expensed in the year incurred. In addition, taxpayers will be entitled, for R&D expenditure up to €20 million to a yearly extra super-deduction of 50%. To the extent that R&D expenditure reaches beyond €20 million, taxpayers may deduct 25% of the exceeding amount.
- **Allowance for Growth and Investment (AGI):** the proposal for a common corporate tax base will include a rule against debt bias, in order to neutralize the current framework that discourages equity financing (debt financing provides for deductible interest payments). Taxpayers will be given an allowance for growth and investment according to which increases in their equity will be deductible from their taxable base subject to certain conditions, such as measures against potential cascading effects and anti-tax avoidance rules.
- **Temporary loss relief with recapture:** in order to partially make up for the absence of the benefits of cross-border consolidation under the CCTB, there will be a possibility to consider, under strict conditions, losses incurred by an immediate subsidiary or permanent establishment situated in other EU Member States. This relief will be temporary since the parent company will add back to its tax base, considering the amount of losses previously deducted, any subsequent profits made by its immediate subsidiaries or permanent establishments.
- **Loss compensation:** losses may be carried forward without any limitation, but carry-back is not possible. However, the CCTB proposal also contains an anti-abuse provision to discourage the circumvention of the rules on loss deductibility through purchasing loss-making companies.
- **Interest limitation rules:** under the CCTB proposal, full deductibility of interest (and other financial) costs is allowed to the extent that they can be offset against taxable interest (and other financial) revenues. Any surplus of interest costs...
will be subject to deductibility restrictions, to be determined by reference to a taxpayer’s taxable earnings before interest, tax, depreciation and amortization (EBITDA).

- Anti-tax avoidance: The system will include a General Anti-Abuse Rule (GAAR) which is drafted in line with the text featuring in the ATA Directive. In addition, the rules include a so-called switch-over clause, which is targeted against certain types of income originating in a third country. It aims to ensure that income is taxable in the European Union if it was taxed below a certain level in the third country. Furthermore, Controlled foreign company legislation (CFC) largely refers to the rule in the ATA Directive and has the effect of re-attributing the income of a low-taxed controlled subsidiary to its parent company in an effort to discourage profit shifting.

- Hybrid mismatches: Given that mismatches generate from national differences in the legal qualification of certain types of entities or financial payments, they should normally not occur amongst companies which apply the common rules for calculating their tax base. Since, however, mismatches are likely to persist in the interaction between the framework of the common base and national or third-country corporate tax systems, the CCTB proposal also lays down rules whereby one of the two jurisdictions in a mismatch deny the deduction of a payment or ensures that the corresponding income is included in the common base.

**CCCTB proposal**

Under the CCCTB proposal profits are not allocated by means of transfer pricing, but allocated among the EU Member States by a formulary apportionment. The factors that determine this formulary apportionment calculation are labor, sales and assets. In this regard, it should be pointed out that intangible assets (i.e. Intellectual Property, brands, logo’s) are not taken into account in the formulary appointment because intangible assets are, according to the European Commission, easily movable and have a high risk of circumventing the tax system. EU Member States that rely on a strong services economy, such as Denmark and the Netherlands, oppose the current formulary appointment out of fear of losing corporate tax income and a decrease in foreign direct investment. At this stage, it is unlikely that EU Member States will reach an agreement on the CCCTB proposal within a short period of time.

Interestingly, the CCTB does not touch up the different statutory tax rates within the EU, despite the common tax base there would still be rate arbitrage between the different EU Member States.

If approved, the CCTB would enter into force on 1 January, 2019 and the CCCTB directive would enter into force as per 1 January, 2021.

**ATA Amendment Directive**

The original ATA Directive contains general anti-abuse rules against tax evasion by multinational companies, such as interest deduction limitation rules, enhancement of CFC rules and rules against hybrid mismatch arrangements. The ATA Amendment Directive expands the scope by introducing anti-abuse rules with regard to hybrid mismatch arrangements involving third countries. The ATA Amendment Directive provides the following rules against hybrid mismatch arrangements:

- EU Member States are not allowed to grant a deduction, if a payment gives rise to double deduction or deduction without corresponding taxation.
- In case a payment by a taxpayer situated in a third country results in deduction without inclusion or non-taxation without inclusion, the EU Member State is required to include this payment in the taxable base of their taxpayer, unless the third country has already denied the deduction or has required that payment to be included.

**Dispute resolution**

The European Commission also proposes a directive that contains changes to the current disputes mechanism between EU Member States in case of double taxation. It is generally accepted that double taxation of the same taxable income has a negative impact on cross-border investments and leads to economic inefficiencies and distortions. At present, there are two dispute resolution mechanisms in the EU, the Mutual Agreement Procedures (MAP) which are foreseen in Double Taxation Conventions (DTCs) and the Union Arbitration Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises. The dispute resolution mechanisms with regard to double taxation issues, that are currently in place have significant inadequacies as regards the scope of mandatory binding dispute resolution, enforceability and efficiency. Although, companies that are within the CCTB and CCCTB system will encounter...
less double taxation issues, double taxation issues could still arise for instance in relation to non-EU companies or with regard to companies that fall outside the scope of the CCTB and CCCTB directive. The directive proposal contains the following elements to improve the dispute resolution mechanisms that are currently in place in the EU:

- the scope is widened; it applies to all double taxation disputes regarding income from business
- it is more effective; it provides mandatory resolution for double taxation disputes (if necessary by means of arbitration within a strict time frame)
- ensures fairness; it sets out when access to national courts should be granted for clarifying whether there is an obligation to eliminate double taxation and if so, provides the national court with a possibility to take action
- it is flexible; it allows EU Member States to reflect future trends for solving their double taxation disputes provided that the double taxation is eliminated within the timelines laid down in the directive
- it increases transparency; abstracts of the decisions will be published

If unanimously approved by the EU Member States, this directive will enter into force on 1 January, 2018.

AUTHORS

Jian-Cheng Ku
Partner
Amsterdam | T: +31 (0)20 541 98 88
jian-cheng.ku@dlapiper.com